THE METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA

MASTER SWAP POLICY

September 11, 2001

1. Authority

A Master Swap Resolution ("Master Resolution") of the Board of Directors of the Metropolitan Water District of Southern California ("Metropolitan") authorizing the execution and delivery of interest rate swap transactions and related agreements was approved on September 11, 2001. The Master Resolution authorizes Metropolitan to enter into swap transactions from time to time to better manage assets and liabilities and take advantage of market conditions to lower overall costs and reduce interest rate risk.

The Master Resolution authorizes the execution of swaps and related agreements, provides for security and payment provisions, and sets forth certain other provisions related to swap agreements between Metropolitan and qualified swap counterparties. In the event of a conflict between the terms of the Master Resolution and the terms of the Master Swap Policy, the terms and conditions of the Master Resolution shall control.

2. Purpose

The incurring or carrying of obligations and management of investments by Metropolitan involves a variety of interest rate payments and other risks that a variety of financial instruments are available to offset, hedge, or reduce. It is the policy of Metropolitan to utilize such financial instruments to better manage its assets and liabilities. Metropolitan may execute interest rate swaps if the transaction can be expected to result in the following:

- Reduce exposure to changes in interest rates on a particular financial transaction or in the context of the management of interest rate risk derived from Metropolitan's overall asset / liability balance.
- Result in a lower net cost of borrowing with respect to Metropolitan's debt or achieve a higher net rate of return on investments made in connection with, or incidental to the issuance, incurring, or carrying of Metropolitan's obligations or other Metropolitan investments.
- Manage variable interest rate exposure consistent with prudent debt practices and guidelines approved by the Board.

Metropolitan shall not enter into interest rate swaps for speculative purposes.

3. Form of Swap Agreements

Each interest rate swap executed by Metropolitan shall contain terms and conditions as set forth in the International Swap and Derivatives Association, Inc. ("ISDA") Master Agreement, including any schedules and confirmations as approved in accordance with Article II, Section 2.01 (a) (ii) and (iii) of the Master Resolution. The swap agreements between Metropolitan and each qualified swap counterparty shall include payment, term, security, collateral, default, remedy, termination, and other terms, conditions and provisions as the Chief Financial Officer, in consultation with the General Counsel, deems necessary or desirable.

4. Transaction Approval

The approval guidelines for each authorized swap transaction shall be as set forth in Article II, Section 2.01 (a) (iii) of the Master Resolution and in this Section 4. The required approval of any swap transaction will be based upon the notional amount of the swap and the average life of the swap. The following table sets forth the approval requirements for each swap transaction:

	Approval Requirements		
Average Life of Swap	Board Approval	Ad Hoc Committee	CFO Approval
5 years or less	greater than $300M	>$ 50M, up to $300M	$ 50M or less
>5 years <10 years	greater than $250M	>$ 50M, up to $250M	$ 50M or less
10 years or greater	greater than $200M	>$ 50M, up to $200M	$ 50M or less

In addition, if multiple swap transactions with one or more counterparties are contemplated over a three-month period, which would exceed the approval limits as described above, then the additional transaction approvals would be required. The total notional amount of swap transactions including the average life of the swap agreements over a consecutive three-month period shall be considered to determine if approval is required from the Board or the Ad Hoc Committee (comprised of the Chairman of the Board, the Chairman of the Audit, Budget and Finance Committee, and the President and Chief Executive Officer).

For example, if Metropolitan enters into a $50 million swap agreement for 15 years, approval for this transaction would be required from the Chief Financial Officer only. However, if within the same three month period Metropolitan proposes to enter into a second 15 year swap agreement for $50 million, then approval for the second swap transaction would be required by the Ad Hoc Committee of the Board.

5. Qualified Swap Counterparties

Metropolitan shall be authorized to enter into interest rate swap transactions only with qualified swap counterparties. Qualified swap counterparties are identified in

Metropolitan's Board approved investment banking team. The composition of the approved swap counterparties will change from time to time as changes are made to Metropolitan's investment banking team. Qualified swap counterparties must be rated at least "Aa3" or "AA-", or equivalent by any two of the nationally recognized rating agencies (i.e. Moody's, Standard and Poor's, or Fitch); or have a "AAA" subsidiary as rated by at least one nationally recognized credit rating agency. In addition, the counterparty must have a demonstrated record of successfully executing swap transactions as well as creating and implementing innovative ideas in the swap market. Each counterparty shall have minimum capitalization of at least $150 million.

Metropolitan may negotiate or competitively bid an interest rate swap transaction based on a review of the market impact to Metropolitan of such competitive bid.

6. Termination Provisions

All swap transactions shall contain provisions granting Metropolitan the right to optionally terminate a swap agreement at anytime over the term of the agreement. In general, exercising the right to optionally terminate an agreement produces a benefit to Metropolitan, either through receipt of a payment from a termination, or if a termination payment is made by Metropolitan, in conjunction with a conversion to a more beneficial (desirable) debt obligation of Metropolitan as determined by Metropolitan. The Chief Financial Officer or the Ad Hoc Committee, as appropriate, in consultation with the General Counsel, shall determine if it is financially advantageous for Metropolitan to terminate a swap agreement.

Mandatory Termination: A termination payment to or from Metropolitan may be required in the event of termination of a swap agreement due to a default or a decrease in credit rating of either Metropolitan or the counterparty. *It is the intent of Metropolitan not to make a termination payment to a counterparty that does not meet its contractual obligations. Prior to making any such termination payment, the Chief Financial Officer shall evaluate whether it is financially advantageous for Metropolitan to obtain a replacement counterparty to avoid making such termination payment.*

In the event of default by a counterparty whereby Metropolitan would be required to make a termination payment, Metropolitan will proceed as follows:

- In order to mitigate the financial impact of making such payment at the time such payment is due; Metropolitan will seek to replace the terms of the terminated transaction with a replacement counterparty. The new or replacement counterparty will make an upfront payment to Metropolitan in an amount that would offset the payment obligation of Metropolitan to the original counterparty.
- If a satisfactory agreement with a replacement counterparty is not reached, Metropolitan will be required to make a swap termination payment to the original defaulting counterparty. Funds for such payment shall be made from available monies. The Chief Financial Officer shall report any such termination payments to the Board at the next Board meeting.

7. Term and Notional Amount of Swap Agreement

Metropolitan shall determine the appropriate term for an interest rate swap agreement on a case by case basis. The slope of the swap curve, the marginal change in swap rates from year to year along the swap curve, and the impact that the term of the swap has on the overall exposure of Metropolitan shall be considered in determining the appropriate term of any swap agreement. In connection with the issuance or carrying of bonds, the term of a swap agreement between Metropolitan and a qualified swap counterparty shall not extend beyond the final maturity date of existing debt of Metropolitan, or in the case of a refunding transaction, beyond the final maturity date of the refunding bonds. At no time shall the total notional amount of all swaps exceed the total amount of outstanding water revenue bonds.

8. Swap Counterparty Exposure Limits

In order to diversify Metropolitan's counterparty risk, and to limit Metropolitan's credit exposure to any one counterparty, limits will be established for each counterparty based upon both the credit rating of the counterparty as well as the relative level of risk associated with each existing swap transaction. The risk measure will be calculated based upon the mark-to-market sensitivity of each transaction to an assumed shift in interest rates. Assuming a 25 basis point movement in the swap rate, the maximum net exposure (termination payment) per counterparty shall not exceed the following amounts:

Credit Rating	Maximum Net Sensitivity to a 25 Basis Point Shift in the Yield Curve
Fully Collateralized	$10,000,000
AAA	$10,000,000
AA	$ 8,000,000

"The maximum net exposure limitations establish guidelines with respect to whether Metropolitan should enter into an additional swap agreement with an existing counterparty. For example, assume Metropolitan executed a fifteen-year $400 million notional amount swap with a "AAA" rated counterparty. If the yield curve moved 25 basis points, Metropolitan could have a significant market exposure to that swap counterparty (i.e. in order to terminate the swap Metropolitan would have to make a payment of up to $10 million dollars). The same scenario would apply to a fully collateralized counterparty. If such event occurred, the Chief Financial Officer would evaluate whether it is prudent and advisable to enter into additional swap transactions with such counterparties in order to mitigate the exposure to such counterparty. For "AA" rated counterparties the maximum net exposure limitation is reduced to $8 million given its lower credit rating."

The calculation of net interest rate sensitivity per counterparty will take into consideration multiple transactions, some of which may offset market interest rate risk thereby reducing overall exposure to Metropolitan. In addition, additional exposure provisions are as follows:

- The sum total notional amount per swap counterparty may not exceed 25 percent of Metropolitan's total revenue bond indebtedness.
- The appropriate collateral amount will be determined on a case by case basis, and approved by the Chief Financial Officer in consultation with the General Counsel.

If the sensitivity limit is exceeded by a counterparty, Metropolitan shall conduct a review of the exposure sensitivity limit calculation of the counterparty. The Chief Financial Officer shall evaluate appropriate strategies in consultation with the Office of the General Counsel to mitigate this exposure.

9. Collateral Requirements

As part of any swap agreement, Metropolitan shall require collateralization or other credit enhancement to secure any or all swap payment obligations. As appropriate, the Chief Financial Officer, in consultation with the General Counsel may require collateral or other credit enhancement to be posted by each swap counterparty under the following circumstances:

- Each counterparty to Metropolitan may be required to post collateral if the credit rating of the counterparty or parent falls below the "AA" category. Additional collateral for further decreases in credit ratings of each counterparty shall be posted by each counterparty in accordance with the provisions contained in the collateral support agreement to each swap agreement with Metropolitan.
- Collateral shall consist of cash, U.S. Treasury securities and Agencies.
- Collateral shall be deposited with a third party trustee, or as mutually agreed upon between Metropolitan and each counterparty.
- A list of acceptable securities that may be posted as collateral and the valuation of such collateral will be determined and mutually agreed upon during negotiation of the swap agreement with each swap counterparty.
- The market value of the collateral shall be determined on at least a monthly basis.
- Metropolitan will determine reasonable threshold limits for the initial deposit and for increments of collateral posting thereafter.
- The Chief Financial Officer shall determine on a case by case basis whether other forms of credit enhancement are more beneficial to Metropolitan.

10. Reporting Requirements

A written report providing the status of all interest rate swap agreements will be provided to the Board of Directors at least on a quarterly basis and shall include the following information:

- Highlights of all material changes to swap agreements or new swap agreements entered into by Metropolitan since the last report.
- Market value of each of Metropolitan's interest rate swap agreements.
- The net impact to Metropolitan of a 25 basis point movement (up or down) with the appropriate swap index or curve.
- For each counterparty, Metropolitan shall provide the total notional amount position, the average life of each swap agreement, the available capacity to enter into a swap transaction, and the remaining term of each swap agreement.
- The credit rating of each swap counterparty and credit enhancer insuring swap payments, if any.
- Actual collateral posting by swap counterparty, if any, per swap agreement and in total by swap counterparty.
- A summary of each swap agreement, including but not limited to the type of swap, the rates paid by Metropolitan and received by Metropolitan, and other terms.
- Information concerning any default by a swap counterparty to Metropolitan, and the results of the default, including but not limited to the financial impact to Metropolitan, if any.
- A summary of any planned swap transactions and the impact of such swap transactions on Metropolitan.
- A summary of any swap agreements that were terminated.

The Chief Financial Officer together with the General Counsel shall review Metropolitan's swap policy on an annual basis and recommend appropriate changes to the Board.